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**BEFORE THE
POSTAL RATE COMMISSION**

POSTAL RATE COMMISSION
OFFICE OF THE CLERK

POSTAL RATE AND FEE CHANGES, 1997

DOCKET NO. R97-1

**DIRECT TESTIMONY OF
STEPHEN E. SELICK
ON BEHALF OF
UNITED PARCEL SERVICE**

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INTRODUCTION

1
2 My name is Stephen E. Sellick. I am an Associate at Putnam, Hayes
3 & Bartlett, Inc. ("PHB"), an economic and management consulting firm with offices
4 in Washington, D.C.; Cambridge, Massachusetts; Los Angeles and Palo Alto,
5 California; a New Zealand subsidiary with offices in Auckland and Wellington; an
6 Australian subsidiary with offices in Melbourne and Sydney; and a United Kingdom
7 affiliate, Putnam, Hayes & Bartlett Ltd., with offices in London. I am located in
8 PHB's Washington, D.C., office, 1776 Eye Street, N.W., Washington, D.C. 20006.

9 I have more than eight years of consulting experience, including a
10 wide range of assignments in regulatory economics, cost accounting, and financial
11 analysis of regulated industries. In addition, I have extensive experience in
12 environmental litigation, including projects dealing with the allocation of common
13 costs.

1 I have worked on PHB's analytic investigations of United States
2 Postal Service ("Postal Service") costing issues since 1990. In Docket No. R90-1
3 and again in Docket No. R94-1, I assisted Dr. George R. Hall in the preparation of
4 testimony regarding the attributable costs of Parcel Post, Priority Mail, and Express
5 Mail. In Docket No. R94-1, I assisted Dr. Colin C. Blaydon in the preparation of
6 analyses and testimony concerning the treatment of mixed mail costs in the In-
7 Office Cost System ("IOCS"). In Docket No. MC95-1, I assisted Ralph L. Luciani in
8 the preparation of analyses and testimony regarding the costs associated with
9 parcels handled by the Postal Service in First Class and Standard (A) Mail and in
10 supplemental testimony regarding rate design for Standard Mail (A) parcels.

11 Since 1995 I have visited and observed the operations of a number of
12 Postal Service facilities, including the Washington, D.C., BMC on two different
13 occasions, a Sectional Center Facility, two Processing and Distribution Centers,
14 two Associate Offices/Delivery Units, a HASP (Hub and Spoke Project) facility, and
15 an Airport Mail Center.

16 I hold a B.S. in Economics from the University of Pennsylvania's
17 Wharton School of Business and an M.A. in Public Policy Studies from the
18 University of Chicago.

19 PURPOSE OF TESTIMONY

20 I have been asked to review those aspects of the costing proposals of
21 the Postal Service which are discussed below. In so doing, I reviewed the
22 testimony and workpapers of Postal Service witnesses Degen (USPS-T-12),

Alexandrovich (USPS-T-5), Moden (USPS-T-4), Patelunas (USPS-T-15), Crum (USPS-T- 28), Bradley (USPS-T-14), and Daniel (USPS-T-29).

My testimony provides the following:

1. An examination of Mr. Degen's Management Operating Data System-based ("MODS") costing changes to Cost Segment 3, and suggested revisions.

2. A recalculation of base year and test year costs under 100 percent mail processing labor cost variability as recommended by UPS witness Kevin Neels (UPS-T-1).

3. A calculation of the mail processing unit cost differences between Priority Mail flats and Priority Mail parcels. UPS witness Ralph L. Luciani (UPS-T-3) uses this cost differential to develop a Priority Mail parcel surcharge.

4. The identification of the costs of certain Parcel Post operations which are then used by Mr. Luciani to calculate a more appropriate DBMC discount.

MODS-BASED ALLOCATION OF MAIL PROCESSING COSTS

The Postal Service presents two witnesses who address mail processing labor costs in Cost Segment 3: Mr. Degen (USPS-T-12) and Dr. Bradley (USPS-T-14). These two witnesses address entirely separate aspects of this subject; Mr. Degen's testimony deals with how to distribute mail processing

1 labor costs among the subclasses of mail, while Dr. Bradley testifies about the
2 degree to which mail processing labor costs are variable and therefore attributable.

3 In my testimony, I address only the subject covered by Mr. Degen, the
4 distribution of costs to subclasses of mail.¹ Specifically, I discuss why Mr. Degen's
5 approach represents an improvement over past practice. I also explain why
6 criticisms of MODS piece handling data applicable to Dr. Bradley's analysis do not
7 affect Mr. Degen's methodology, which uses MODS workhours data to distribute
8 those costs found to be attributable. Finally, I recommend that, with minor
9 programming modifications, Mr. Degen's approach to distributing mail processing
10 labor costs to each mail subclass be adopted by the Commission.

11 A. Mr. Degen's MODS-Based Approach Is An
12 Improvement Over Past Practice.

13 Mr. Degen's approach to distributing attributable mail processing
14 labor costs to subclasses is an improvement over past Postal Service and
15 Commission practice in two important respects: (1) it links the distribution of mixed
16 mail and "overhead" (not handling mail) costs with the operational characteristics of
17 mail processing; and (2) it incorporates information on the contents of items (e.g.,
18 sacks, bundles, trays, and pallets) and containers more completely into the
19 distribution of mixed mail costs. I discuss each of these improvements in turn.

20 In previous cases, the Postal Service has relied on IOCS and
21 LIOCATT (a series of Postal Service computer programs) to distribute attributable

1. Dr. Neels addresses Dr. Bradley's testimony.

1 mail processing costs for clerks and mailhandlers by subclass. IOCS is a work
2 sampling system which estimates the proportion of time clerks and mailhandlers
3 spend on different activities associated with the processing of each type of mail
4 and providing each type of special service. The time proportions are then used to
5 distribute attributable in-office costs to subclasses of mail and special services.

6 IOCS observations can be "direct" or "mixed." Direct observations are
7 recorded when the IOCS data collector observes an employee handling (a) a single
8 piece of mail; (b) an item or container that contains only one subclass of mail
9 ("identical" items and containers); or (c) a sufficiently random non-identical item by
10 recording the subclass of the top piece using the "top piece rule." Mixed tallies are
11 those observations in which the employee is engaged in an activity involving a
12 mixture of different classes or shapes of mail. Mixed mail tallies include uncounted
13 items and containers as well as "working but not handling mail" observations.
14 IOCS also records "overhead" tallies, which are observations when the employee is
15 on break, clocking in or clocking out, or moving empty equipment.

16 The LIOCATT procedure formerly used by the Postal Service
17 distributed the costs associated with mixed mail to the subclasses of mail in
18 proportion to the class and shape distribution of direct mail tallies. LIOCATT
19 accomplished this process through cost pools ("strata") grouped by CAG and Basic
20 Function.² Overhead costs were then distributed to subclasses of mail in
21 proportion to the final distribution of direct and mixed mail costs.

2. CAG stands for Cost Ascertainment Group, a classification of facilities based on revenue.

1 Mr. Degen's revised methodology differs from the previous
2 methodology in four ways: (1) hours data from MODS are used to partition clerk
3 and mailhandlers' compensation costs into "cost pools" based on certain mail
4 processing activities and machinery types; (2) the distribution of mixed mail costs is
5 stratified by these cost pools rather than by CAG and Basic Function; (3) the mixed
6 mail distribution incorporates IOCS data on container contents; and (4) variability
7 estimates, developed by Dr. Bradley, are then applied to each of the cost pools.

8 Table 1 compares the Postal Service's current approach in this case
9 with the previous methodology for the key elements involved:

Table 1

Comparison of Key Elements: LIOCATT versus Postal Service Proposal

Issue	R94-1 (LIOCATT)	R97-1 (MODS/IOCS)
Division of Cost Segment 3 Labor Costs Among Mail Processing, Window Service, and Administrative Costs	IOCS Based	MODS Based
Cost Pools for Distributing Mixed Mail Tallies	CAG and Basic Function Only	MODS operation, BMC operation type, or Basic Function
Uncounted Items Distribution Key	All Direct Mail and Counted Mixed Mail within Cost Pool	Mail subclasses observed for the same type of item within the same Cost Pool
Uncounted Container: Items Distribution Key	All Direct Mail and Counted Mixed Mail within Cost Pool	Mail subclasses observed for the same type of item within the same Cost Pool
Uncounted Container: Loose Mail Distribution Key	All Direct Mail and Counted Mixed Mail within Cost Pool	Mail subclasses observed for the same mail shape within the same Cost Pool
Not Recorded and Empty Container Distribution Key	All Direct Mail and Counted Mixed Mail within Cost Pool	Mail subclasses observed for the same container type within the same Cost Pool
Overhead Distribution Key	Final Cost Distribution	Mail subclass in the cost pool where overhead is incurred

The Postal Service's new approach is a significant improvement over previous practice. The primary point of difference between the new and the old techniques is to refine the mixed mail distribution methodology. As the table above notes, the previous method (LIOCATT) for distributing mixed mail costs grouped costs into "pools" based on (1) CAG, which relates to the amount of revenue generated by a postal facility, and (2) the Basic Function involved, which relates to the type of processing operation -- Incoming, Outgoing, Transit, and Other. The

1 new method also uses cost "pools," but these cost pools represent a much finer
2 level of distribution than LIOCATT. The new pools relate to operational
3 characteristics and machine type, which affect the costs incurred in processing
4 mail, instead of CAG and Basic Function, which do not drive mail processing labor
5 costs.³

6 The new method treats mixed mail observed in OCR operations, for
7 example, as likely to be similar to direct mail at OCR operations. The old method
8 was much less refined; it assumed that mixed mail observed in OCR operations
9 was similar to all direct mail at postal facilities of a similar size and Basic Function.
10 The old method ignored the fact that mixed mail at OCR operations is more likely to
11 resemble direct mail at OCR operations than direct mail at OCR and non-OCR
12 operations. In fact, the old method completely ignored available operational data
13 which recognize the different character of various mail processing operations.

14 In adopting this refinement, the Postal Service has addressed long-
15 standing concerns that intervenors and the Commission have expressed about the
16 costs associated with "not handling mail" IOCS tallies. The new method assures
17 that the costs of "not handling mail" are allocated to the subclasses of mail that are
18 found on the same machine type or in the same processing operation when
19 employees are handling mail. If, for example, postal employees in the manual
20 Priority Mail processing operation are more frequently observed working but not
21 handling mail, the costs of the time they spend while not actually handling mail will

3. For non-MODS offices, the new approach continues to use Basic Function to define the cost pools.

1 be allocated only to the subclasses of mail with which those employees work when
2 they are handling mail.

3 Postal Service reports as far back as 1992 have recommended
4 essentially this approach. For example, a report prepared for the Postal Service by
5 Foster Associates states:

6 "the present undifferentiated allocation of equipment
7 handling costs as 'overhead' needs review because,
8 with automation (and, for that matter, mechanization) as
9 distinct from manual processing, some mail classes are
10 apparently more dependent on containerization and
11 related handling equipment than others."⁴

12 This observation clearly indicates that distributing "not handling mail" costs (in this
13 case, the costs of moving empty equipment) to subclasses of mail on the basis of
14 machine-specific and operation-specific cost pools (as proposed by the Postal
15 Service in this case) results in a more accurate measurement of the relationship
16 between "not handling mail" costs and the subclasses of mail which give rise to
17 those costs.
18

19 This logic is not limited to the cost of moving empty equipment. The
20 same report made a similar observation for break time, another significant
21 component of "not handling mail" costs; because "continuing negotiated increases
22 of break time can be expected as automation is extended to previously non-

4. *Overhead and Subclass Cost Study*, prepared for the United States Postal Service under Contract No. 104230-90-B-0505 by Foster Associates Inc., November 1992 ("Foster Associates Report"), page 5.

1 automated situations,” the cost of breaks should be distributed within operation and
2 machine-specific cost pools, as proposed by the Postal Service.⁵

3 An additional improvement in the new cost methodology is that mixed
4 mail distributions now reflect actual data on the contents of items and containers.
5 Previous Postal Service practice allocated the costs of containers with mixed
6 shapes of mail in proportion to the set of all direct mail tallies. This ignores the fact
7 that different types of containers are used for different types (subclasses) of mail.
8 On the other hand, Mr. Degen “exploits the association of item types within certain
9 shapes and/or subclasses of mail.”⁶ He does so by “using the corresponding
10 piece- or item-handling distribution” by cost pool to allocate the costs of containers
11 for which the contents were identified as (a) items or (b) loose mail shapes.⁷ This
12 technique recognizes the relationship between item types and certain classes or
13 shapes of mail by distributing the costs of uncounted items in proportion to the
14 direct mail in those item types.⁸ For those containers for which the contents are not
15 identified, Mr. Degen similarly makes use of the association of different container
16 types with different classes or subclasses of mail and allocates non-identified

5. Foster Associates Report, page 5.

6. USPS-T-12, page 10.

7. USPS-T-12, pages 9-10.

8. For example, the cost of uncounted Blue & Orange sacks (used for Express Mail) are distributed in proportion to the direct mail in Blue & Orange sacks. LIOCATT would distribute those costs in proportion to all direct mail, ignoring the fact that Blue & Orange sacks are designated for Express Mail use. See Tr. 12/6580.

1 container costs in proportion to direct plus identified container contents by cost
2 pool.

3 In summary, the Postal Service's new methodology (using cost pools
4 based on machine and operation type as well as counted mixed mail) is superior to
5 the old LIOCAT process. The new system takes advantage of "more and better
6 information for the mixed-mail distribution."⁹ It should be adopted by the
7 Commission.

8 B. The Criticisms of MODS Piece Handling
9 Data Do Not Apply to Mr. Degen's Use of
10 MODS Workhours Data.

11 Postal Inspection Service audits have directed significant criticisms at
12 the MODS piece handlings data relied upon by Dr. Bradley.¹⁰ Dr. Neels discusses
13 how crucial this piece handling data is to Dr. Bradley's analysis and how its lack of
14 reliability calls into serious question Dr. Bradley's conclusions regarding the degree
15 to which mail processing labor is other than 100 percent variable with volume.

16 It is important to understand that while Dr. Bradley's analysis is
17 undermined by these criticisms, Mr. Degen's analysis is not affected by them. Mr.
18 Degen does not rely upon the MODS piece handling data in his analysis; he relies
19 only upon the employee workhours data from MODS in order to partition mail
20 processing labor costs into cost pools, as described above. The MODS workhours

9. Tr. 12/6421.

10. *National Coordination Audit: Mail Volume Measurement and Reporting Systems, United States Postal Inspection Service, December 1996, LR-H-220.*

1 data are directly linked to the Postal Service's payroll system, creating additional
2 accounting and managerial controls, and have been measured on the same basis
3 for at least nine years.¹¹

4 In short, criticisms of the ability of MODS to measure piece handlings
5 have no bearing on Mr. Degen's analysis since he does not use that data.¹²

6 C. Mr. Degen's Distribution Method Should
7 Be Used With Minor Modifications.

8 The improvements the Postal Service has implemented in distributing
9 the costs in Cost Segment 3 should be adopted whether or not the Commission
10 chooses to continue the long-standing practice of attributing 100 percent of mail
11 processing labor costs. Two improvements made by Mr. Degen -- addressing the
12 increase in overhead/not handling mail tallies and refining the methods used to
13 distribute mixed mail costs -- have no necessary relationship to the degree of
14 variability of mail processing labor costs. The methodology outlined by Mr. Degen
15 can be easily adapted to incorporate full attribution of mail processing labor costs.

16 Decoupling Mr. Degen's distribution key analysis from the Postal
17 Service's proposal to abandon the historical attribution level of mail processing
18 labor costs does, however, require some small modifications. The Commission has

11. Tr. 11/5878.

12. Some questions have been raised about the degree to which Postal employees actually clock into the MODS operation in which they are working. Postal supervisors have a strong incentive for ensuring the accuracy of the workhours data, since different supervisors are responsible for different operations. Mr. Degen has adequately responded to these questions. See, e.g., Tr. 12/6554-56.

1 found, in very limited instances, that some mail processing labor costs are fixed
2 and not attributable.¹³ In addition, the “migration” of some costs previously
3 classified as administrative (and assigned to Cost Segment 3.3) but now included
4 in Cost Segment 3.1 must be reversed to ensure treatment consistent with the
5 Commission’s established practice. The essential improvements introduced by the
6 Postal Service -- stratifying the mixed mail distribution process on the basis of
7 operational characteristics and more fully utilizing actual data on counted mixed
8 mail -- are maintained in this approach. Table 2 compares the Postal Service’s
9 proposal with Dr. Neels’ recommended treatment of Cost Segment 3, which returns
10 attribution to 100 percent.

13. One example is “working, but not handling mail” while working on the Platform (Activity Code 6210).

Table 2

BY 1996 Volume Variable Cost Segment 3.1 Costs by Subclass

Class and Subclass of Mail or Special Service	Postal Service Proposal	100% Attribution
Letters and sealed parcels	4,774,417	5,692,578
Presort letters and sealed parcels	1,080,864	1,266,581
Single Piece Cards	140,336	169,913
Presort private post cards	37,457	44,141
Total First Class Mail	6,033,074	7,173,213
Priority Mail	477,606	691,160
Express Mail	83,202	134,947
Mailgrams	79	96
Within county	15,210	18,324
Regular rate publications	467,201	579,246
Nonprofit publications	81,970	101,269
Classroom publications	5,720	7,510
Total Periodicals Mail	570,101	706,348
Single piece rate	75,564	94,605
Bulk - Regular Carrier Presort	256,941	321,133
Bulk - Regular Other	1,486,117	1,816,337
Total Standard (A) Regular	1,743,058	2,137,471
Bulk - Nonprofit Carrier Presort	27,934	34,457
Bulk - Nonprofit Other	353,421	419,303
Total Bulk Nonprofit	381,355	453,760
Total Standard (A) Mail	2,199,977	2,685,835
Parcels (zone rate)	153,080	222,030
Bound printed matter	71,247	98,253
Special rate	65,485	92,035
Library rate	15,647	22,020
Total Standard (B) Mail	305,459	434,339
Penalty - U. S. Postal Service	92,173	133,141
Free Mail for Blind/Handicapped	10,378	14,066
International Mail	214,584	277,141
Total All Mail	9,986,633	12,250,286
Total Special Services	116,331	189,666
Total Volume Variable	10,102,964	12,439,952
Other	3,144,448	386,232
Total Costs	13,247,412	12,826,184

Sources: Postal Service Proposal – USPS-T-5, WP A-2, pages 3-4; 100% Attribution – UPS-Sellick-WP-I-A2, Mail Processing Adjustments Sheet.

1 **BASE YEAR AND TEST YEAR**
2 **COST CALCULATIONS**

3 I have calculated Base Year 1996 (BY1996) and Test Year 1998 After
4 Rates (TYAR) costs with mail processing labor costs at 100 percent attribution.¹⁴
5 To estimate the effect that changes in the level of attribution and in the distribution
6 of BY1996 mail processing labor costs in Cost Segment 3 have on TYAR costs, I
7 developed a simplified roll-forward model. Under this model, BY1996 to TYAR
8 costs change in the same proportion as in the Postal Service's proposal. In
9 particular, for each BY1996 cost component which changes as a result of
10 modifications I make to Cost Segment 3, the following calculation is made:

- 11 • The TYAR/BY1996 ratio resulting from the Postal Service's proposal
12 is calculated for each subclass; and
- 13 • My revised BY1996 cost by subclass is then multiplied by the Postal
14 Service TYAR/BY1996 ratio to calculate the new TYAR costs.

15 A comparison of the Postal Service's proposal with my results is
16 presented in Tables 3 (Base Year) and 4 (Test Year).

14. In so doing, I have used the Postal Service's treatment of Alaska Air costs, that is, Alaska Air is essentially 100% attributable to Parcel Post. The result of using the Commission's Docket No. R94-1 treatment of TYAR Alaska Air costs is presented by the Postal Service in LR-H-215 (Rule 54(a)(1) Alternate Commission Cost Presentation) (Rollforward) (Revised).

Table 3

BY 1996 Volume Variable Costs by Subclass

Class and Subclass of Mail or Special Service	Postal Service Case	Recommended Approach
Letters and sealed parcels	\$12,046,631	13,400,624
Presort letters and sealed parcels	3,804,528	4,087,648
Single Piece Cards	429,135	472,880
Presort private post cards	125,994	136,169
Total First Class Mail	16,406,288	18,097,321
Priority Mail	1,584,229	1,867,621
Express Mail	342,623	410,971
Mailgrams	432	461
Within county	75,056	79,844
Regular rate publications	1,448,904	1,607,084
Nonprofit publications	317,766	345,527
Classroom publications	14,874	17,338
Total Periodicals Mail	1,856,600	2,049,792
Single piece rate	188,355	215,018
Bulk - Regular Carrier Presort	1,821,927	1,925,248
Bulk - Regular Other	4,164,366	4,640,443
Total Standard (A) Bulk Regular	5,986,293	6,565,691
Bulk - Nonprofit Carrier Presort	136,575	146,685
Bulk - Nonprofit Other	969,720	1,066,513
Total Bulk Nonprofit	1,106,295	1,213,199
Total Standard (A) Mail	7,280,943	7,993,908
Parcels (zone rate)	694,997	789,067
Bound printed matter	285,041	322,853
Special rate	226,526	263,321
Library rate	47,835	56,599
Total Standard (B) Mail	1,254,399	1,431,840
Penalty - U. S. Postal Service	196,097	250,816
Free Mail for Blind/Handicapped	26,406	31,595
International Mail	1,158,518	1,244,755
Total All Mail	30,106,535	33,379,080
Total Special Services	1,236,416	1,332,188
Total Volume Variable	31,342,951	34,711,268
Other	23,633,646	20,265,331
Total Costs	54,976,597	54,976,599

Sources: Postal Service Case -- Exhibit USPS-5A, pages 7-8; Recommended Approach
-- UPS-Sellick-WP-I-CI, Base Year Costs Sheet.

Table 4

Test Year 1998 Volume Variable Costs by Subclass

Class and Subclass of Mail or Special Service	Postal Service Case	Recommended Approach
Letters and sealed parcels	\$12,466,968	13,821,126
Presort letters and sealed parcels	4,002,534	4,307,303
Single Piece Cards	432,141	474,538
Presort private post cards	158,372	171,401
Total First Class Mail	17,060,015	18,774,368
Priority Mail	2,138,518	2,456,169
Express Mail	410,906	489,151
Mailgrams	502	532
Within county	80,424	85,339
Regular rate publications	1,561,106	1,724,399
Nonprofit publications	327,861	355,223
Classroom publications	12,619	14,634
Total Periodicals Mail	1,982,010	2,179,595
Single piece rate	221,691	251,857
Bulk - Regular Carrier Presort	1,894,839	2,000,034
Bulk - Regular Other	5,360,184	5,954,194
Total Standard (A) Bulk Regular	7,255,023	7,954,228
Bulk - Nonprofit Carrier Presort	128,014	137,208
Bulk - Nonprofit Other	1,120,767	1,228,893
Total Bulk Nonprofit	1,248,781	1,366,101
Total Standard (A) Mail	8,725,495	9,572,186
Parcels (zone rate)	731,136	828,452
Bound printed matter	328,929	370,998
Special rate	254,900	294,772
Library rate	48,569	57,136
Total Standard (B) Mail	1,363,534	1,551,359
Penalty - U. S. Postal Service	172,926	219,791
Free Mail for Blind/Handicapped	31,429	37,377
International Mail	1,193,999	1,278,539
Total All Mail	33,079,334	36,559,067
Total Special Services	1,364,626	1,457,421
Total Volume Variable	34,443,960	38,016,489
Other	26,246,161	22,677,365
Total Costs	60,690,121	60,693,854

Sources: Postal Service Case -- USPS-T-15, WP-G, Table D, pages 7-8, adjusted for misallocation of Phase I PMPC contract, Tr. 13/7293-96; Recommended Approach -- UPS-Sellick-WP-1-I-C1, TYAR Summary Sheet.

1 These revised TYAR costs are used by UPS witness J. Stephen
2 Henderson (UPS-T-3) to develop his pricing proposals for certain subclasses of
3 mail.

4 **PRIORITY MAIL PROCESSING COST**
5 **DIFFERENCES BY SHAPE**

6 The Postal Service's own data show that Priority Mail parcels are, on
7 average, more expensive to process than are Priority Mail flats.

8 The SAS program MODSHAPE in LR-H-146 calculates "costs by
9 shape for selected BASE YEAR rate categories" using the new MODS cost pools
10 for mail processing costs.¹⁵ While the output provided by the Postal Service does
11 not include costs by shape for Priority Mail, the MODSHAPE program is easily
12 modified to include Priority Mail costs by shape in its output.¹⁶ Essentially, the
13 Postal Service has made this calculation but has not presented the results. My
14 modification uses the Postal Service's data and analytic techniques; I simply
15 extract from the Postal Service's data the results for Priority Mail in addition to the
16 results the Postal Service calculates for other subclasses of mail.

17 The following table shows the resulting mail processing costs by
18 Shape for Priority Mail (TY 1998):

15. LR-H-146, Part III, pages III-2 through III-15.

16. See UPS-Sellick-WP-1-III-C for the details of the modifications to
 MODSHAPE needed to make this calculation.

Table 5

**Mail Processing Costs by Shape for Priority Mail (TY 1998)
Mail Processing Labor Costs 100% Attributable**

Mail Shape	BY 1996 Mail Processing Cost	BY 1996 Volume	Cost per Piece
Flats	\$214,628	344,192	\$0.624
IPPs & Parcels	\$442,427	589,192	\$0.751
Difference			0.127
times BY Piggyback Factor			1.45
times TY/BY Wage Adjustment			1.053
Adjusted TY Difference			\$0.195

Source: UPS-Sellick-WP-1-III-A, page 2.

This mail processing cost difference between Priority Mail flats and Priority Mail parcels is used by Mr. Luciani in proposing a Priority Mail parcel surcharge.

**RECALCULATION OF DBMC NON-TRANSPORTATION
COSTS AVOIDED IN OUTGOING OPERATIONS**

In his Exhibit C, Postal Service witness Crum (USPS-T-28) attempts to estimate the test year outgoing mail processing unit costs avoided by DBMC Parcel Post. He calculates avoided costs of 37.7 cents per piece.

In his calculation, Mr. Crum uses a methodology different from that used by the Commission and the Postal Service in previous proceedings. In particular, the Commission's established methodology excludes the costs for Mail

1 Preparation (Operation Code 01) and Platform Acceptance (Operation Code 07) in
2 calculating the costs avoided by DBMC Parcel Post. Mr. Crum, on the other hand,
3 treats these costs as part of the costs avoided by DBMC Parcel Post. Also, a
4 premium pay adjustment has traditionally been made by the Commission, but is not
5 made by Mr. Crum. In his testimony, Mr. Luciani recommends that the
6 Commission's methodology should be adopted in this case.

7 In response to an interrogatory asking why he did not adjust his
8 avoided cost calculation to exclude mail preparation and platform acceptance
9 costs, Mr. Crum indicated that "it would not have been possible to make the
10 adjustments as such."¹⁷ However, the SAS data sets in LR-H-146 contain the data
11 needed to make these adjustments. The results are presented in Table 6. This
12 table also shows the amount of the premium pay adjustment traditionally made by
13 the Commission.

17. Tr. 5/2285.

Table 6
Parcel Post Costs Excluded from
DBMC Avoided Cost Calculation

Summary by Office Type	Postal Service Attribution of Cost Segment 3	100 Percent Attribution of Cost Segment 3
All Offices Operation Codes 01 and 07	\$4,250	\$5,867
BMC Offices Excluding Operation Codes 01 and 07	\$31,686	\$51,187
Premium Pay Adjustment	\$885	\$1,295

Source: UPS-Sellick-WP-1-IV-A, page 1.

Mr. Luciani uses these calculations to arrive at a revised DBMC discount.

SUMMARY OF CONCLUSIONS

In conclusion, I find that:

- Mr. Degen's MODS-based approach to distributing attributable mail processing labor costs to subclasses is an improvement over past practice and should be adopted by the Commission. Mr. Degen's approach more closely aligns the distribution of mixed mail and overhead costs to mail processing operational characteristics and more fully utilizes Postal Service data on counted mixed mail. The result is an improved distribution of the costs in Cost Segment 3.
- MODS-based costing can be implemented while returning to the historical practice of attributing 100 percent of mail processing labor costs. Mr. Degen's MODS-based approach should be adopted by the

1 Commission. The Base Year and Test Year results of such an
2 analysis are provided in my testimony.

- 3 • Extraction of existing data based on the Postal Service's own analytic
4 techniques demonstrates that Priority Mail parcels are, on average,
5 more expensive to process than are Priority Mail flats. This data is
6 presented in my testimony and is used by Mr. Luciani to develop a
7 surcharge for Priority Mail parcels.
- 8 • The data are available to revise the Postal Service's computation of
9 the non-transportation costs avoided by DMBC in outgoing operations
10 in accordance with previous Commission and Postal Service practice.
11 These data are presented in my testimony and are used by Mr.
12 Luciani to calculate a revised DBMC discount.